Dems' Int'l Tax Policy Comes With Unintended Consequences

By George Callas

On Sept. 9, the Biden-Harris campaign released a fact sheet enumerating several specific international tax legislative proposals that former Vice President Joe Biden and Sen. Kamala Harris, D-Calif., would pursue if elected.[1] The campaign describes these proposals as falling under the categories of "Made in America" tax policy and closing the Trump offshoring loopholes.[2]

Unfortunately, these labels do not accurately describe the substance of the actual proposals, and — in the case of the latter category — actually might encourage foreign ownership of global activity over U.S. ownership.

One of the most important characteristics of these proposals is that they only apply to U.S. multinational groups, and not to foreign multinational groups. Thus, to the extent U.S. companies are competing with foreign companies, these proposals would disadvantage U.S.-based companies.

The Biden-Harris proposals rest on a flawed premise: that for U.S. companies, foreign investment and domestic investment is a zero-sum game, and that more of the former means less of the latter. Rather, the two are mutually reinforcing, and when U.S. companies are successful abroad, they expand headquarters and support operations in the U.S.

Capital will flow to profitable opportunities overseas. The only question is whether that capital will flow through U.S. companies or through foreign companies. The Biden-Harris plan would make it more likely that capital would flow through foreign companies.

Modifications to the Tax Cuts and Jobs Act

Is there any validity to the claim that the Tax Cuts and Jobs Act created a permanent tax giveaway?[3] The answer is no. The Biden-Harris claim of offshoring loopholes already has been rejected by nonpartisan experts and fact-checkers. For instance, the Joint Committee on Taxation found that, "The proposals affecting taxation of foreign activity are expected to reduce the incentives for this 'profit-shifting' activity, thus resulting in an increase in the U.S. tax base."[4]

The JCT further concluded that, The macroeconomic estimate projects an increase in investment in the United States, both as a result of the proposals directly affecting taxation of foreign source income of U.S. multinational corporations, and from the reduction in the after-tax cost of capital in the United States due to more general reductions in taxes on business income.[5]

Washington Post fact-checker Glenn Kessler concluded that Biden and Harris' "claim that companies got 'a reward for offshoring jobs' is not confirmed in the available data. ... Moreover, the law is believed to have broadly reduced incentives to invest overseas, compared to the previous system."[6]

So, if the claim of offshoring loopholes itself is flawed, then what of the Biden-Harris proposals to close those alleged loopholes? Not only do the proposals represent solutions in
search of a problem, but they also likely damage the ability of U.S. businesses to compete globally.

**GILTI Per-Country Approach**

The global intangible low-taxed income, or GILTI, regime adopts an aggregate approach to limiting profit-shifting, meaning that the foreign earnings, foreign taxes and foreign qualified business asset investment, or QBAI, of all of a U.S. taxpayer's controlled foreign corporations are largely treated as consolidated for GILTI purposes.[7]

In effect, the GILTI regime divides the world into two jurisdictions: U.S. and foreign. Biden and Harris, however, propose to replace this with a per-country approach that requires a U.S. taxpayer with controlled foreign corporations to calculate its GILTI separately in each foreign jurisdiction in which it operates.[8]

The extensive deliberations and reasoning that led to Congress' decision that an aggregate approach is superior to a per-country approach have been detailed elsewhere,[9] but the Biden-Harris approach would prioritize protecting the tax bases of foreign governments at the expense of making U.S. companies less competitive abroad.

To understand this conclusion, one must consider the typical structure of a global U.S. company. Such businesses do not operate through independent, ring-fenced operations in each country whose market they serve. Rather, they tend to operate regionally — such as through a European structure, an Asian structure, etc.

U.S. companies that sell to German customers locate operations in Europe rather than the U.S. because they must be close to the market. Those that sell to Japanese customers will locate operations in East Asia instead of the U.S. for the same reason. These are usually business-driven decisions, not tax-driven decisions.

Once a U.S. company makes the decision to expand into a foreign region, the question then arises where to locate various functions within that region. Should a U.S. company locate high-margin functions such as research and marketing in high-tax Germany or low-tax Switzerland?

To compete better with foreign multinational corporations also serving the European market, a U.S. company might decide to pay less tax to Switzerland rather than more tax to Germany. But either way, neither the real economic activity nor the taxable income is likely to be located in the U.S..

GILTI's current aggregate approach recognizes that protecting Germany's tax base is not a national policy priority — especially when doing so disadvantages U.S. companies vis-à-vis foreign companies. If a U.S. company's only foreign activity — including profits, taxes and QBAI — is in a tax haven with no corporate income tax, then that suggests the foreign location is motivated by tax considerations and the company will receive little or no benefit from the ability to aggregate earnings, taxes and QBAI.

On the other hand, if a U.S. company has earnings, taxes and QBAI in both high-tax and low-tax jurisdictions — such as France (high), Germany (high), Switzerland (low) and Ireland (low) — it is more likely operating in Europe for business reasons rather than tax reasons and therefore is justified in benefiting from the aggregate approach.

By replacing the aggregate approach with a per-country approach, the Biden-Harris plan
would penalize a U.S. company that operates in Europe for business reasons for choosing Switzerland over Germany.

**Repealing Territorial Treatment for Routine Returns**

A major premise of the GILTI regime is that global U.S. companies do not relocate tangible property to avoid U.S. tax on routine returns, because the costs — both tax and nontax — of relocating physical assets are too high and the tax savings on routine returns are too meager. Rather, profit-shifting involves the migration of intangible property for the purpose of avoiding U.S. tax on supernormal returns, given the relatively low-cost of relocating intangible assets and the potentially significant tax savings associated with high returns.

For that reason, GILTI generally exempts controlled foreign corporation income equivalent to 10% of QBAI — with QBAI defined largely as aggregate adjusted basis in depreciable property.[10] Taxpayers then may repatriate that amount, intended as a proxy for a routine return on invested capital, free of U.S. residual tax.[11]

Some commentators have asserted that the treatment of QBAI creates an incentive for global U.S. companies to shift depreciable property — and with it jobs — out of the U.S. to exempt a greater portion of controlled foreign corporation income from GILTI.

Biden and Harris have accepted this argument in proposing to:
End the Trump Loophole of allowing U.S companies to pay ZERO taxes on the first 10% of their profits when they locate manufacturing and service jobs in foreign nations.[12]

Consider, however, the modest GILTI tax benefit that a taxpayer could achieve by increasing its foreign QBAI compared with the tax and nontax costs of moving real activity overseas.

In the simplest case of a no-tax jurisdiction, if a taxpayer moves $100 of QBAI offshore, it will (1) exempt a $10 return from GILTI, and (2) increase its foreign-derived intangible income by $10 in year one. This would lead to a GILTI tax savings of $1.05 and a foreign-derived intangible income tax savings of 79 cents,[13] for a total tax savings of $1.84, 1.84% of the QBAI moved. Each year thereafter, the return will decline as the adjusted basis of the QBAI is reduced for depreciation.

This $1.84 tax savings, however, is dwarfed by lost depreciation deductions. The taxpayer would lose $100 of depreciation deductions, increasing its U.S. tax by $21, yielding a net tax increase of $19.16 in year one (assuming the $100 is eligible for bonus depreciation), or a return of negative 19.16%. Subsequent years are highly unlikely to ever yield a $21 cumulative tax savings.[14] But even in the rare case where it might, the nontax costs and risks of moving tangible property to a different country — different bodies of law, political dynamics, workforces, infrastructure, transportation, etc. — easily overwhelm any microscopic tax savings.

**Doubling the GILTI Rate**

By increasing the base GILTI rate from 10.5% to 21%,[15] the Biden-Harris proposals would open up a substantial gap between the effective tax rates paid by U.S. and foreign companies competing in foreign markets. Most foreign companies do not pay effective rates approaching 21%, and thus imposing such a rate on the foreign earnings of U.S. companies would make servicing foreign markets through a company with a U.S. headquarters less attractive.
The proposal could increase pressure on U.S. companies to engage in inversions, and otherwise make it more difficult for U.S. companies to outbid foreign companies for acquisitions. In all these cases, the U.S. economy loses and foreign economies gain.

**Offshoring Tax Penalty**

Biden and Harris propose a 10% surtax — i.e., 10% of the regular tax due — "on profits of any production by a United States company overseas for sales back to the United States." The proposal explains that, coupled with Biden's proposed 28% corporate tax rate, this would lead to a rate of 30.8%.

But as described above, the Biden-Harris proposal would raise the GILTI rate to 21%, and so it is not clear how this surtax would interact with GILTI. Under GILTI, the income of controlled foreign corporations is not subject to the full corporate rate of 28%, and so the advertised 30.8% rate does not appear consistent with how Biden and Harris propose to tax controlled foreign corporations.

Does the proposal only apply to income subject to the full 28% corporate rate, such as income earned directly by the U.S. taxpayer (e.g., through a foreign branch) and Subpart F income? If so, the offshoring tax penalty would apply to a relatively limited number of structures.

Imposing a higher tax rate on imports by U.S. companies than on imports by foreign competitors, however, seems a questionable policy outcome. In a recent Law360 article, Kyle Pomerleau of the American Enterprise Institute said, "[T]he surcharge would have some of the same effects as a tariff."[16] But this quasi-tariff would apply only to U.S. companies selling into the U.S., while exempting foreign companies.

**Conclusion**

The choices made by the TCJA — including the GILTI rate, the aggregate approach and the routine return exemption — represent attempts to balance carefully the competing policy priorities of protecting the U.S. tax base from profit-shifting and maintaining the competitive balance between U.S. and foreign multinationals. The Biden-Harris proposals discard the latter policy priority and adopt revenue-raising as the only goal, with no discernable recognition of trade-offs for global U.S. companies and their employees.

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[2] By "Trump Offshoring Loopholes," the Biden-Harris campaign is referring to Section 14201 of the Tax Cuts and Jobs Act, which created the global intangible low-taxed income,
or GILTI, regime.


[5] Id. at 7.


[7] See generally Internal Revenue Code § 951A.

[8] Supra note 1 at 4.


[10] See IRC § 951A(b), (d). For this purpose, adjusted basis is determined using the alternative depreciation system of IRC § 168(g).


[12] Supra note 1 at 4. Presumably, by profits Biden and Harris mean the return on qualified business asset investment.

[13] See IRC § 250(a)(1)(A) for how the foreign derived intangible income tax benefit is calculated.

[14] For a more detailed example, including time value of money considerations, see https://twitter.com/George_A_Callas/status/1219970952219332608.

[15] Supra note 1 at 4. The Biden-Harris plan would achieve the 21% rate by increasing the statutory corporate tax rate to 28% and then reducing the IRC § 250 deduction to 25%.